12/20/10 - New Requirements for Tax-Exempt Charitable Hospitals

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Background

Section 501(c)(3) of the Internal Revenue Code[1] sets out the legal standard for determining whether a not-for-profit hospital is exempt from federal income tax, using a facts and circumstances approach to assess whether a hospital is exempt or taxable.[2] Until the late 1960s, the Internal Revenue Service (IRS) required these hospitals to provide, to the extent of their financial ability, free or reduced-cost care to patients unable to afford it. In 1969, however, the IRS issued Revenue Ruling 69-545, which "remove[d] the requirements relating to caring for patients without charge or at rates below cost."[3] Since 1969, the IRS has required not-for-profit hospitals to meet a community benefit standard[4] ? a facts and circumstances test whereby hospitals are judged on whether they promote the health of a broad class of individuals in the community. A legal challenge to this shift in policy failed in the mid-1970s.[5] This implementation brief examines the addition of Section 501(r) to the Internal Revenue Code under the Affordable Care Act (ACA), which sets out new requirements for these not-for-profit, tax-exempt hospitals.

Like the "financial ability" test for exemption that existed prior to 1969, the community benefit standard is also sufficiently vague as to make measurement and enforcement difficult.[6] While certain states have taken an aggressive stance over the years with respect to state property tax exemption and have refused to recognize property tax exemption in the absence of measurable performance, the federal government has not taken this approach. More recently not-for-profit hospitals have come under increasing congressional[7] and IRS[8] scrutiny, following media reports of hospitals' refusal to discount or forgive bills in the case of indigent persons and where imposition of the highest charges for uninsured and under-insured patients was accompanied by aggressive collection actions. A 2009 report by the IRS found "considerable diversity" in hospitals' community benefit activities; similarly, a 2008 GAO report[9] valued the federal tax exemption alone at nearly $13 billion in 2002 (a figure that does not include the total value of the exemption to hospitals when state tax laws also are considered) and concluded that the vagueness of federal requirements precluded effective enforcement. As a result, community benefit activities have, until passage of the Affordable Care Act, remained largely a matter of individual hospital discretion, and state law requirements, and informal IRS guidance.

The ACA amendments were preceded by earlier legislative proposals to tighten tax

exemption standards, and in recent years not-for-profit hospitals have been the subject of more than 45 class action lawsuits challenging their tax exempt status on the basis of their billing practices and treatment of low-income or uninsured individuals.[10] In 2009, not-for-profit hospitals were required to file supplemental information with the IRS in order to illuminate their community benefit-related spending.[11] However, given the limited nature of the supplemental data collection, and the difficulties inherent in attempting to measure expenditures against what it means to provide community benefit,[12] the debate continued.

Changes Made by the Health Reform Law
P.L. 111- 148, § 9007

The ACA amends the Internal Revenue Code by adding new section 501(r), titled "Additional requirements for certain hospitals."[13] The new requirements apply to "a facility which is required by a State to be licensed, registered, or similarly recognized as a hospital," and "any other organization which the Secretary determines has the provision of hospital care as its principal function or purpose."[14] Where a hospital organization operates more than one facility, each and every facility is required to meet the requirements set forth in the new provisions.[15] The following ACA provisions relate to charitable hospitals:

• *Community health needs assessment*:[16] A not-for-profit hospital must conduct a "community health needs assessment" every three years, in addition to adopting an "implementation strategy" to meet the needs established by the assessment. This provision applies beginning with the taxable year two years after the enactment of the law. In order to qualify as a community health needs assessment:

• The assessment and implementation strategy must be carried out on a recurring basis suggesting an ongoing need for updating and modification as the service area or other conditions change.
• The assessment must "take into account" "input" from persons who "represent" the "broad interest" of the "community served by the hospital facility." The statute does not define these terms but the text suggests that each hospital facility in a multi-facility corporation presumably would have to show that its assessment was carried out in relation to people who represented the community served by that facility.
• The assessment must include "those" with "special knowledge or

expertise in public health" suggesting a link to public health not only in terms of the content of information collected through the assessment but also the assessment process itself. That is, the assessment process ? as well as its structure and content ? potentially must reflect knowledge and public health expertise. The legislative history indicates that hospitals may use existing public health information and may work with other organizations.[17] But the text also suggests that the process include more than just compiled public health information and must also include information gleaned from "those" with special knowledge and public health expertise.

• The assessment must be made "widely available" to the "public." The term "public" could denote the general public or public within the service area. The term "available" is not defined but given its overall goal of community health needs assessment, the text suggests not only geographic availability but potentially availability in a cultural and linguistic sense, and potentially availability in a manner that comports with the hospital's other duties under other federal laws such as Title VI of the 1964 Civil Rights Act, §504 of the Rehabilitation Act of 1973, the Americans with Disabilities Act, and other relevant laws.

• The hospital must have "adopted" an "implementation strategy." The term "adopted" is not defined, nor is the term "implementation strategy." The term "adopted" suggests in the context of hospital organizations, a formal activity, while the term "implementation strategy" may or may not mean the actual implementation of the plan or more simply, a strategy for implementing the plan.

• *Financial Assistance and Emergency Medical Care Policies*:[18]

• A not-for-profit hospital must have a written financial assistance policy which includes:

• "eligibility criteria", including whether or not the assistance includes free or discounted care;
• "the basis for calculating amounts charged to patients";
• "the method for applying for financial assistance";
• in the absence of an existing billings and collection policy, the policy must state the actions the hospital will take in the event of a

nonpayment; and
- "measures to widely publicize the policy within the community...."

- A not-for-profit hospital must also have a written emergency medical care policy which includes:

  - a statement "requiring the organization to provide, without discrimination, care for emergency medical conditions to individuals regardless of their eligibility under the financial assistance policy...."

- *Limitation on Charges*:[19] In order to receive the benefits of a 501(c)(3) tax-exempt organization, a hospital must:

  - place a limit on "amounts charged for emergency or other medically necessary care provided to individuals eligible for assistance under the financial assistance policy... to not more than the lowest amounts charged to individuals who have insurance covering such care"; and
  - the hospital organization must "prohibit[] the use of gross charges."

- *Additional requirements*:[20]

  - Billing and collections: The hospital organization is required to make a determination as to whether an individual is eligible for assistance under the hospital's financial assistance policy before engaging in extraordinary collection actions against a patient.
  - Power of the Secretary: The Secretary of the U.S. Department of Health and Human Services (HHS) is granted the authority to issue regulations and guidance, where necessary, to carry out the provisions of the new requirements for tax-exempt hospitals. Specifically, the

Secretary is granted the authority to determine "what constitutes reasonable efforts to determine the eligibility of a patient under a financial assistance policy...."

Except as noted for the community health needs assessment requirement, all provisions above are applicable to the taxable year beginning after the date of the enactment of the ACA.

The health reform law also amends Subchapter D of section 42 of the Internal Revenue Code to add an excise tax for hospitals failing to meet the new requirements, levying a $50,000 tax on any not-for-profit hospital failing to meet the standards set out in section 501(r).[21] In addition, the ACA adds new reporting requirements for hospitals to which 501(r) applies, as well as additional agency oversight:

• The Secretary of the Treasury (or delegate) is tasked with reviewing the community benefit standard "at least once every three years" to ensure compliance;[22]
• Hospitals to which the new reporting requirements apply are required to provide for each taxable year:

• A description of how the not-for-profit hospital is addressing the needs identified in the community health needs assessment and, additionally, a description of any needs that are not being addressed and why these needs are not being addressed;[23] and
• A copy of their audited financial statements.[24]

• *Agency oversight ? levels of charity care*:[25] The Secretary of the Treasury Department, in consultation with the Secretary of HHS, is required to submit an annual report to the Committees on Ways and Means, Education and Labor, and Energy and Commerce of the House of Representatives and to the Committees on Finance and Health, Education, Labor, and Pensions with the following information:

• The level of charity care provided by not-for-profit hospitals, the amount of bad dept expenses, and unreimbursed costs for services provided with respect to mean-tested and non-means-tested government programs; and
• Information with regarding the costs incurred for community benefit activities.

• *Agency oversight ? report on trends*:[26]

• The Secretary of the Treasury, in consultation with the Secretary of HHS, is required to conduct a study on trends on charity care provided by not-for-profit hospitals and report to the congressional committees of jurisdiction within 5 years. The Secretary must provide a report of the study to the Committees on Ways and Means, Education and Labor, and Energy and Commerce of the House of Representatives and to the Committees on Finance and Health, Education, Labor, and Pensions of the Senate.

Implementation

Agency

The Secretary of Treasury is charged with issuing such regulations and guidance as may be necessary to carry out the new requirements set forth in 501(r). In addition, the Secretary is tasked with tracking the community benefit provided by eligible hospitals at least once every three years. In consultation with the Secretary of HHS, the Secretary of the Treasury is required by the new provisions to submit to Congress annually a report on the level of charity care provided by eligible hospitals, as well as to study and report, over a five-year period, the tends associated with the provision of charity care provided by not-for-profit hospitals.

Key Dates

The ACA requires the Secretary of Treasury to promulgate guidance and regulations relating to the new charitable hospital requirements as may be necessary. In terms of reporting requirements, the provisions require the Secretary to review hospital community benefits every three years, to report annually to Congress on levels of charity care, and to provide a report on a study of charity hospital care within five years.

Process

The health reform law specifies that the Secretary shall issue such regulations and guidance as may be necessary to carry out the provisions set forth, including "guidance relating to what constitutes reasonable efforts to determine the eligibility of a patient under a financial assistance policy."[27]

Key Issues

Defining a community health needs assessment: In the Joint Committee on Taxation's Technical Explanation of the Affordable Care Act, the committee stated that the needs assessment "may be based on current information collected by a public health agency or not-for-profit organizations and may be conducted together with one or more organizations, including related organizations."[28] As the requirements fail to set a threshold, how will the Secretary judge when a tax-exempt hospital has done enough? Are patients or the indigent included in the "broad interests of the community served"? How will the needs assessment be made "widely available to the public"? The provision does not address the relationship between the hospital's needs assessment or implementation planning obligations and its other obligations under the law. For example, nothing in the statute itself requires the assessment to specifically address the needs of the low-income and uninsured population living in its service area or the amount of free care that will be furnished and the manner in which uncompensated care needs will be met. Similarly, the statutory text leaves to agency interpretation the responsibility for defining key terms. The law does not define the term, "community health need assessment," for example but presumably the IRS, in implementing the law, will set parameters on its meaning in order to limit hospital discretion to declare that any activity an organization may elect to undertake qualifies as an assessment.

Limitations on charges: The law specifies that a hospital must limit the amounts charged for care provided to individuals eligible for assistance under the hospital's financial assistance policy to not more than the amounts generally billed to insured patients. At what billing rate will this requirement be met?

Definition of hospital: The law provides that if a hospital organization has more than one hospital facility, the organization must meet the new requirements separately with respect to each hospital, and that the organization will not be treated as a Section 501(c)(3) tax-exempt organization with respect to any facility not meeting the requirements. However, what will happen if one or more of several hospital facilities operated by one entity fail to meet the requirements?

Billing and collections: The law states that a hospital must not engage in extraordinary collection actions before it has made reasonable efforts to determine whether the individual is eligible under the financial assistance policy. How will "extraordinary collection actions" be interpreted? What "reasonable efforts" must be made to determine if an individual is assistance-eligible?

Recent Agency Action

On May 27, 2010 the IRS published Notice 2010-39, soliciting public comments regarding the application of the new requirements for tax-exempt hospitals.[29] Comments were due by July 22, 2010. You can view a selection of the comments online now.[30]

Authorized Funding Levels

The provision is regulatory in nature and therefore does not directly affect the awarding of federal funds.

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[1] 26 USC 501(c)(3).
[2] IRS Exempt Organizations (TE/GE) Hospital Compliance Project Final Report, http://www.irs.gov/pub/irs-tege/frepthospproj.pdf (accessed May 18, 2010).
[3] Rev. Rul. 69-545, 1969-2 C.B. 117.
[4] Prior to 1969, the IRS, operating under Revenue Ruling 56-185, required hospitals to provide, to the extent of its financial ability, free or reduced-cost care to patients unable to afford it. In 1969, however, the IRS issued Revenue ruling 69-545 which "remove[d] the requirements relating to caring for patients without charge or at rates below cost." (Rev. Rul. 69-5454, 1969-2 C.B. 117). Since 1969, the community benefit standard has ruled.
[5] In *EKWRO v Simon*, the United States Supreme Court held that taxpayers had no standing to enforce the charitable care standards. 426 U.S. 26 (1976).
[6] Tax-Exempt Section 501(c)(3) Hospitals: Community Benefit Standard and Schedule H, CRS Report for Congress, July 31, 2008.
[7] Letter from Senator Chuck Grassley, Chairman of the Committee on Finance, to

the Honorable Donald L. Korb, Chief Counsel, Internal Revenue Service. June 1, 2006.
[8] IRS Exempt Organizations (TE/GE) Hospital Compliance Project Final Report, http://www.irs.gov/pub/irs-tege/frepthospproj.pdf (accessed May 18, 2010).
[9] Not-for-profit Hospitals: Variation in Standards and Guidance Limits Comparison of How Hospitals Meet Community Benefit Requirements, GAO-08-880 September 12, 2008, http://www.gao.gov/new.items/d08880.pdf (accessed June 1, 2010).
[10] 501(c)(3) Hospitals and the Community Benefit Standard, CRS Report for Congress, November 10, 2009.
[11] IRS, Form 990 Redesign for Tax Year 2008 Schedule H, Hospitals ? Highlights, at 5-6, Dec. 20, 2007.
[12] Gray B, Palmer H, Fix Schedule H Shortcomings, Hospitals and Health Networks 84:3, March 2010.
[13] 26 USC 501(r).
[14] P.L. 111-148 §9007.
[15] P.L. 111-148 §9007.
[16] P.L. 111-148 §9007.
[17] Joint Committee on Taxation,Technical Explanation of the Revenue Provisions of the "Reconciliation Act of 2010," as amended, in combination with the "Patient Protection and Affordable Care Act" (JCX-18-10), at 81, March 21, 2010.
[18] P.L. 111-148 §9007.
[19] P.L. 111-148 §9007.
[20] P.L. 111-148 §9007.
[21] P.L. 111-148 §9007.
[22] P.L. 111-148 §9007.
[23] P.L. 111-148 §9007.
[24] P.L. 111-148 §9007.
[25] P.L. 111-148 §9007.
[26] P.L. 111-148 §9007.
[27] P.L. 111-148 §9007.
[28] Joint Committee on Taxation, Technical Explanation of the Revenue Provisions of the "Reconciliation Act of 2010," as amended, in combination with the "Patient Protection and Affordable Care Act" (JCX-18-10), at 81, March 21, 2010.
[29] Request for Comments Regarding Additional Requirements for Tax-Exempt Hospitals, Notice 2010-39, http://www.irs.gov/pub/irs-drop/n-10-39.pdf.
[30] http://www.wallerlaw.com/quotes/2010/08/10/comments-available-for-review.

26 USC 501(c)(3).IRS Exempt Organizations (TE/GE) Hospital Compliance Project Final Report, http://www.irs.gov/pub/irs-tege/frepthospproj.pdf (accessed May 18, 2010).Rev. Rul. 69-545, 1969-2 C.B. 117.Prior to 1969, the IRS, operating under

Revenue Ruling 56-185, required hospitals to provide, to the extent of its financial ability, free or reduced-cost care to patients unable to afford it. In 1969, however, the IRS issued Revenue ruling 69-545 which "remove[d] the requirements relating to caring for patients without charge or at rates below cost." (Rev. Rul. 69-5454, 1969-2 C.B. 117). Since 1969, the community benefit standard has ruled.In *EKWRO v Simon*, the United States Supreme Court held that taxpayers had no standing to enforce the charitable care standards. 426 U.S. 26 (1976).Tax-Exempt Section 501(c)(3) Hospitals: Community Benefit Standard and Schedule H, CRS Report for Congress, July 31, 2008.Letter from Senator Chuck Grassley, Chairman of the Committee on Finance, to the Honorable Donald L. Korb, Chief Counsel, Internal Revenue Service. June 1, 2006.IRS Exempt Organizations (TE/GE) Hospital Compliance Project Final Report, http://www.irs.gov/pub/irs-tege/frepthospproj.pdf (accessed May 18, 2010).Not-for-profit Hospitals: Variation in Standards and Guidance Limits Comparison of How Hospitals Meet Community Benefit Requirements, GAO-08-880 September 12, 2008, http://www.gao.gov/new.items/d08880.pdf (accessed June 1, 2010).501(c)(3) Hospitals and the Community Benefit Standard, CRS Report for Congress, November 10, 2009.IRS, Form 990 Redesign for Tax Year 2008 Schedule H, Hospitals ? Highlights, at 5-6, Dec. 20, 2007.Gray B, Palmer H, Fix Schedule H Shortcomings, Hospitals and Health Networks 84:3, March 2010.26 USC 501(r).P.L. 111-148 §9007.P.L. 111-148 §9007.Joint Committee on Taxation,Technical Explanation of the Revenue Provisions of the "Reconciliation Act of 2010," as amended, in combination with the "Patient Protection and Affordable Care Act" (JCX-18-10), at 81, March 21, 2010.P.L. 111-148 §9007.P.L. 111-148 §9007.P.L. 111-148 §9007.P.L. 111-148 §9007.P.L. 111-148 §9007.P.L. 111-148 §9007.P.L. 111-148 §9007.P.L. 111-148 §9007.P.L. 111-148 §9007.P.L. 111-148 §9007.Joint Committee on Taxation, Technical Explanation of the Revenue Provisions of the "Reconciliation Act of 2010," as amended, in combination with the "Patient Protection and Affordable Care Act" (JCX-18-10), at 81, March 21, 2010.Request for Comments Regarding Additional Requirements for Tax-Exempt Hospitals, Notice 2010-39, http://www.irs.gov/pub/irs-drop/n-10-39.pdf. http://www.wallerlaw.com/quotes/2010/08/10/comments-available-for-review.